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In the Supreme Court of the United States

OCTOBER TERM, 1952

No. 544

PARK & TILFORD DISTILLERS CORPORATION,
PETITIONER
v.
THE UNITED STATES

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINION BELOW

The opinion of the Court of Claims (R. 17–24) is reported at 107 F. Supp. 941.

JURISDICTION

The judgment of the Court of Claims was entered on November 4, 1952. (R. 24.) The petition for a writ of certiorari was filed January 12, 1953. The jurisdiction of this Court is invoked under 28 U. S. C., Sec. 1255 (1).

QUESTION PRESENTED

An officer of the petitioner corporation, who was also a director and stockholder, engaged in short-

swing transactions in the stock of the petitioner and realized a profit from the transactions. He was required to pay this profit over to the petitioner under the provisions of Section 16 (b) of the Securities Exchange Act of 1934. The question presented is whether the amount received by the petitioner constitutes taxable income to the petitioner in the year of receipt.

STATUTES INVOLVED

Internal Revenue Code:

> SEC. 22. GROSS INCOME.
>
> (a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * *, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *
>
> * * * * *
>
> (26 U. S. C. 1946 ed., Sec. 22.)

Securities Exchange Act of 1934, c. 404, 48 Stat. 881:

SEC. 16. (a) Every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered on a national securities exchange, or who is a director or an officer of the issuer of such security, shall file, at the time of the registration of such security or within ten days after he becomes such beneficial owner, director, or officer, a statement with the exchange (and a duplicate original thereof with the Commission) of the amount of all equity securities of such issuer of which he is the beneficial owner, and within ten days after the close of each calendar month thereafter, if there has been any change in such ownership during such month, shall file with the exchange a statement (and a duplicate original thereof with the Commission) indicating his ownership at the close of the calendar month and such changes in his ownership as have occurred during such calendar month.

(b) For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than

six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection.

* * * * *

(15 U. S. C. 1946 ed., Sec. 78p.)

STATEMENT

During the year 1944 and for several years prior thereto, David A. Schulte was an officer, direc-

tor and stockholder of the petitioner corporation and was the owner of more than ten percent of its outstanding capital stock. This stock was not an exempted security within the meaning of the Securities Exchange Act of 1934 and was registered on a national securities exchange. (R. 8.)

During the period commencing October 20, 1942, and ending May 29, 1944, Schulte purchased and sold, or sold and purchased, in the open market, 9,900 shares of petitioner's stock. Schulte was at all times during those transactions the beneficial owner of the securities involved, and they had not been acquired by Schulte in connection with a debt previously contracted. Each purchase and sale, or sale and purchase, occurred within a six-month period and in those short-swing transactions Schulte realized a profit of $264,827.57. (R. 8.)

Schulte paid this amount of $264,827.57 to the petitioner on June 19, 1944, and August 17, 1944, upon demand made by the petitioner at the insistence of a stockholder. (R. 7.)

On or about March 15, 1945, petitioner filed its federal income and personal holding-company tax returns for the calendar year 1944. These returns reported a net loss and no tax liability, and in them the petitioner did not include as income for year 1944 the sum of $264,827.57 received from Schulte. (R. 8–9.)

Deficiencies in the company's income and personal holding company taxes were assessed by the Commissioner for the year 1944 in the respective

amounts of $101,153.51 and $128,770.73. These deficiencies were based upon certain adjustments in petitioner's income, comprising the inclusion in gross income for both income and personal holding-company tax purposes of the sum of $264,827.57 paid to petitioner in 1944 by Schulte. Petitioner paid that amount, plus interest, on April 7, 1949. (R. 9.)

On April 28, 1949, petitioner filed a claim for refund for the year 1944 on the ground that the amount paid to it by Schulte pursuant to the provisions of Section 16 (b) of the Securities Exchange Act of 1934 was not properly includible in its income for that year. (R. 9.)

The Court of Claims, upon suit for a refund by the petitioner, held that the $264,827.57, which the petitioner had received from Schulte, was properly included in the gross income of the petitioner within the meaning of Section 22 (a) of the Internal Revenue Code. (R. 17–24.)

ARGUMENT

1. The decision below is clearly correct. Section 22 (a) of the Internal Revenue Code (*supra,* p. 2) imposes a tax upon income derived from specifically enumerated sources and also upon "gains or profits and income derived from any source whatever." "The broad language of § 22 (a) supports the declarations of this Court that Congress in enacting that section exercised its full power to tax income." *Rutkin* v. *United States,* 343 U. S. 130, 139. See also *Helvering* v. *Clifford,* 309 U. S.

331, 334; *Corliss* v. *Bowers,* 281 U. S. 376, 378; *United States* v. *Safety Car Heating Co.,* 297 U. S. 88, 93; *Helvering* v. *Stockholms &c. Bank,* 293 U. S. 84, 89; *Chicago, R. I. & P. Ry. Co.* v. *Commissioner,* 47 F. 2d 990 (C. A. 7), certiorari denied, 284 U. S. 618.

The payment by Schulte to the petitioner was made upon demand by the petitioner under the rights conferred upon it by Section 16 (b) of the Securities Exchange Act (*supra,* pp. 3–4). That section created a legal obligation, the discharge of which is in no sense a gift. *Robertson* v. *United States,* 343 U. S. 711. Further, petitioner received the payment from Schulte in the lawful conduct of its business. It was the collection of a legal obligation. Collection of an obligation created by law would appear to be as much a business transaction as the collection of any other obligation. It would be incongruous to permit such lawful income to petitioner to escape taxation, while income obtained unlawfully is taxed. See *Rutkin* v. *United States,* 343 U. S. 130.

Petitioner contends, however, that the payment under Section 16 (b) of the Securities Exchange Act was in the nature of a penalty (*Smolowe* v. *Delendo Corp.,* 136 F. 2d 231 (C. A. 2), certiorari denied, 320 U. S. 751), and therefore, constitutes the receipt of non-taxable punitive damages.[1]

[1] There is no question posed in this case as to whether the payment by an insider to the corporation under the provi-

Principal reliance is upon certain language in *Eisner* v. *Macomber,* 252 U. S. 189, where income was defined (p. 207), " 'as the gain derived from capital, from labor, or from both combined,' provided it be understood to include profit gained through a sale or conversion of capital assets." Petitioner insists that the payment received from its fiduciary does not come within this definition. Its position, however, is based upon a conception of taxable income which does not accord sufficient recognition to cases decided by this Court since *Eisner* v. *Macomber.* These cases clearly expand the concept of taxable income.

Thus, in *Helvering* v. *Bruun,* 309 U. S. 461, 468–469, this Court pointed out that the definition of income in *Eisner* v. *Macomber* was merely for the purpose of clarifying the distinction between an ordinary dividend and a stock dividend, and was not otherwise controlling. The *Bruun* case involved the question of whether upon the termination of a lease the lessor, who repossessed the real estate and improvements including a new building erected by the lessee, was taxable upon the increase

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sions of Section 16 (b) constitutes, as to the insider, a penalty and is therefore non-deductible from his gross income. Cf. *Dempsey* v. *Commissioner*, decided September 28, 1951 (1951 P–H T. C. Memorandum Decisions, par. 51, 281); *Davis* v. *Commissioner*, 17 T. C. 549, on appeal to the Court of Appeals for the Ninth Circuit. The only question here presented is whether the receipt of profits realized by an insider in short-swing transactions constitutes taxable income to the corporation. That question was not involved in the *Smolowe* case.

in the value of the property attributable to the new building. Section 22 (a) was held broad enough to embrace the gain in question.

And in *United States* v. *Kirby Lumber Co.*, 284 U. S. 1, this Court stated (p. 3):

> We see nothing to be gained by the discussion of judicial definitions. The defendant in error has realized within the year an accession to income, if we take words in their plain popular meaning, as they should be taken here.

See also *Taft* v. *Bowers*, 278 U. S. 470; *Cooper* v. *United States*, 280 U. S. 409 (in both cases taxpayers were taxed on gains resulting from the accretion in value of the property owned by the taxpayers' donors where the accretion was part of the gifts to the taxpayers); and *Rutkin* v. *United States*, 343 U. S. 130, 137–139.

Therefore, whether or not the payment in question is characterized as penal, the language of Section 22 (a) of the Internal Revenue Code, imposing a tax upon "income derived from any source whatever," is clearly broad enough to include this sum within its purview, and no provision of the statute excludes such payments from gross income.

2. Petitioner asserts several purported conflicts, only one of which would appear to require extended discussion—a 1935 decision of the Court of Appeals for the Third Circuit, *Central R. Co.*

v. *Commissioner*, 79 F. 2d 697.[2] In that case an officer of the taxpayer corporation clandestinely organized other corporations, which were able to operate to the detriment of the taxpayer as a result of information acquired by the faithless fiduciary in the course of his employment. In settlement of the damage claim of the taxpayer corporation, the officer turned over the properties of the corporations which he had organized, and the Commissioner of Internal Revenue imposed a tax on the value of such property. The Court of Appeals held, citing the *Eisner* v. *Macomber* definition of income, that the payments to the railroad corporation were in the nature of a windfall and were therefore not taxable.

We believe that the *Central R. Co.* case was incorrectly decided. Its rationale has been rejected by both the court below and the Court of Appeals for the Second Circuit. See *Sterling* v. *Commissioner*, 93 F. 2d 304, certiorari denied, 303 U. S. 663; *Lyeth* v. *Hoey*, 96 F. 2d 141, reversed on other grounds, 305 U. S. 188. We agree with the court below (R. 23) that its reasoning, which turns on the dictum of *Eisner* v. *Macomber*, no longer has vitality in the law. Regardless, therefore, of

[2] Two recent decisions of the Tax Court have reached the same conclusions as the decision of the Court of Claims below. *General American Investors Co.* v. *Commissioner*, 19 T. C. No. 73 (citing the instant case); *Noma Electric Corp.* v. *Commissioner*, decided January 8, 1953 (1953 P-H T. C. Memorandum Decisions, par. 53,008). Those cases would appear to vitiate any alleged conflict with decisions of that court or its predecessor, the Board of Tax Appeals.

whether its facts are distinguishable from those in the case at bar,[3] we believe that the alleged conflict does not require resolution by this Court.

The other cases cited in petitioner's brief involve either payments made in restoration of capital, payments received as punitive damages, or voluntary contributions. One possible exception is *Edwards* v. *Cuba Railroad,* 268 U. S. 628, where this Court held that a subsidy paid to the railroad did not constitute income, but was a windfall not subject to tax. However, that case merely involved the question of whether a donation or voluntary contribution was taxable income. Such is not the problem here, for Schulte quite obviously did not intend or desire to make any donation or contribution to the petitioner. See *Park & Tilford* v. *Schulte,* 160 F. 2d 984 (C. A. 2, 1947), certiorari denied, 332 U. S. 761. And see *Detroit Edison Co.* v. *Commissioner,* 319 U. S. 98, 102–103.

[3] The recovery in the *Central R. Co.* case resulted from the settlement of a suit by the taxpayer corporation for either an accounting of the profits earned by the newly organized taxpayer corporation in entering into contract with the corporations. The theory of the suit, unlike the nature of the liability created by Section 16 (b) of the Securities Exchange Act, was that the defendants had conspired to defraud the taxpayer corporation. As was stated in a recent article by the Chairman and the Special Counsel of the Securities Exchange Commission, no statute "offers a precise analogy to [Section 16 (b)]." Cook and Feldman, *Insider Trading Under the Securities Exchange Act.* 66 Harv. L. Rev. 385, 408; see also 612–617.

CONCLUSION

The decision below is clearly correct; the petition for writ of certiorari presents no question of importance warranting review; and there is no conflict of decisions requiring resolution by this Court. The petition should therefore be denied.

Respectfully submitted.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1952

No. 544

PARK & TILFORD DISTILLERS CORPORATION,
Petitioner,

—against—

THE UNITED STATES OF AMERICA,
Respondent.

REPLY BRIEF ON BEHALF OF PETITIONER

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March 5, 1953.

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